

General Information Letter: Prior to the enactment of Public Act 91-541, no subtraction modification is allowed for deductions disallowed under Section 280C of the Internal Revenue Code.

February 16, 2000

Dear:

This is in response to your letter dated February 3, 2000, in which you request a letter ruling. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter you have stated the following:

We are responding on behalf of the above mentioned taxpayer to your Notice of Balance Due dated February 13, 2000 (copy enclosed). We believe that the "Other Subtractions" claimed by the taxpayer of \$530,200 were improperly reduced to zero.

The taxpayer is involved in the restaurant business. Its employees, who help service the taxpayer's restaurants, receive tip income. The taxpayer is required to remit the employer's portion for payroll taxes on this tip income. The subtractions claimed by the taxpayer on line 5f of the Illinois Form 1120 represented an economic outlay paid by the taxpayer in the form of payroll taxes. Under Section 45B of the Internal Revenue Code (the "Code"), an employer may claim a credit (the "Federal Tip Credit") equal to the "excess social security tax" paid or incurred by the taxpayer during the taxable year. In general, the excess social security tax means any tax paid under Section 3111 of the Code with respect to tips: (1) received by an employee to the extent such tips are deemed paid by the employer to the employee and, (2) exceed the amount by which the wages (excluding tips) paid to the employee are less than the applicable minimum wage rate. In addition, the only tips received from providing, delivering, or serving food or beverages are taken into account.

Importantly, for federal tax purposes, a taxpayer may not take a deduction for any amount taken into account in determining the Federal Tip Credit. As a result, the taxpayer reduced its payroll tax deduction which had the effect of artificially increasing its federal taxable income. The Federal Tip Credit then served as a reduction in the final calculation of taxes due by the taxpayer. For federal tax purposes, the taxpayer received a greater benefit by claiming the Federal Tip Credit than by claiming a payroll tax deduction.

The starting point for calculating an Illinois corporate taxpayer's base income is its federal taxable income. Since the taxpayer's federal taxable income was artificially inflated, it was necessary for the taxpayer to subtract the portion of its payroll taxes paid which were not deducted for federal tax purposes. By reducing the "Other Subtractions" of \$530,200 to zero, the taxpayer is unfairly denied a deduction for an economic outlay (i.e., payroll taxes) that Illinois recognizes as an ordinary and necessary business expense.

